

**REPORT ON EXAMINATION**  
**AS TO CONDITION OF THE**  
**FLAGSHIP HEALTH SYSTEMS, INC.**  
**PARSIPPANY, NEW JERSEY 07054**  
**AS AT DECEMBER 31, 2006**  
**NAIC COMPANY CODE 11179**  
**NAIC GROUP CODE 2918**

**FILED**

March 4, 2008

Commissioner  
Department of Banking & Insurance



**State of New Jersey**  
**DEPARTMENT OF BANKING AND INSURANCE**  
PO Box 325  
TRENTON, NJ 08625-0325  
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**JON S. CORZINE**  
GOVERNOR

**STEVEN M. GOLDMAN**  
*Commissioner*

November 30, 2007

Honorable Steven M. Goldman  
State of New Jersey  
Commissioner of Banking and Insurance  
20 West State Street  
P.O. Box 325  
Trenton, New Jersey 08625-0325

Commissioner:

In accordance with your instructions and the requirements of the statutes of the State of New Jersey an examination has been made of the condition and affairs of:

FLAGSHIP HEALTH SYSTEMS, INC.

Parsippany, New Jersey 07054

NAIC GROUP CODE 2918

NAIC COMPANY CODE 11179

a domestic dental service plan authorized to transact business in the State of New Jersey. Hereinafter, Flagship Health Systems, Inc. will be referred to as "Flagship" or "Company."

## **SCOPE OF THE EXAMINATION**

The New Jersey Department of Banking and Insurance conducted a financial condition examination of Flagship for the five-year period ending December 31, 2006, which included a review of material transactions and/or events occurring subsequent to the examination date. The examination was conducted at the Company's home office located at 1639 Route 10, Parsippany, New Jersey.

During the period under examination, Flagship's assets decreased \$2,074,959 from \$3,914,647 to \$1,839,688; liabilities decreased \$2,336,088 from \$2,814,445 to \$478,357 and total capital and surplus increased \$261,129 from \$1,100,202 to \$1,361,331.

The conduct of the examination was governed by the procedures outlined in the NAIC and the New Jersey Department of Banking and Insurance Financial Condition Examiner's Handbooks and followed accepted procedures of regulatory authorities and generally accepted insurance company examination standards. In determining emphasis to be placed on specific accounts, consideration was given to the Company's accounting methods and system of internal control, the nature and size of each account, its relative importance to solvency and the annual audit work performed by Flagship's certified public accountants for the period under examination.

Special emphasis was not utilized on any accounts. Standard emphasis, as defined in the New Jersey Financial Condition Examiners Handbook, was used in several instances. The financial accounts requiring standard emphasis were as follows:

- Cash & Short-term Investments
- Uncollected Premiums In The Course of Collection
- Unpaid Claims Adjustment Expenses
- General Expenses Due and Accrued
- Amounts Due to Parent, Subsidiaries and Affiliates
- Unassigned Funds (Surplus)

All other financial accounts required either reduced emphasis or analytical review procedures only.

Additional areas reviewed during this examination were as follows:

- Compliance with Prior Report on Examination Recommendations
- History and Kind of Business
- Territory and Plan of Operation
- Inter-Company Agreements
- Management and Control
- Continuity of Operations
- Policy on Conflict of Interest
- Fidelity Bond and Other Insurance Coverage
- Employee Welfare and Pension Plans
- Policy Forms and Underwriting Practices
- Accounts and Records
- Treatment of Subscribers

The examination report, contained herein, is presented using the alternate format in accordance with the NAIC Financial Condition Examiner's Handbook. The report will address significant balance sheet accounts and, if necessary, comments on those accounts which involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

## **COMPLIANCE WITH PRIOR REPORT ON EXAMINATION RECOMMENDATIONS**

No prior examination was performed for this Company and this section is not applicable.

## **HISTORY AND KIND OF BUSINESS**

The original Certificate of Incorporation of the Company was filed with the Secretary of the State of New Jersey on 9/23/85 as Capital Health Plan Services, Inc. On 12/10/85 an amendment was filed to change the name of the Company to Flagship Health Systems, Inc.

Flagship commenced operations in July 1986 for the purpose of marketing and administering prepaid dental capitation plans in the State of New Jersey as a dental plan organization under N.J.S.A. 17:48D-1 et seq. It is authorized to do business in New Jersey and Pennsylvania, but only writes in New Jersey at this time.

The organization is a wholly owned subsidiary of DDPNJ Corp. ("Corp."), which is a wholly subsidiary of Delta Dental of New Jersey, Inc. (Delta Dental), a not-for-profit dental service corporation. Flagship has \$5,000 in common stock issued and outstanding which is held solely by its parent, DDPNJ Corp. Flagship has no surplus debentures.

Flagship's capitation business is substantially sold in conjunction with the offerings of Delta Dental when clients desire a prepaid dental capitation option.

The principal office of Flagship Health Systems, Inc. is located at 1639 Route 10, Parsippany, New Jersey 07054. The agent in charge upon whom legal process may be served is Douglas G. Sanborn, Senior Vice-President, General Counsel and Secretary.

## **TERRITORY AND PLAN OF OPERATION**

Flagship Health Systems, Inc. ("Flagship") is a dental plan organization formed for the purpose of marketing and administering prepaid dental capitation plans, and is authorized to do business in the State of New Jersey. Flagship's capitation business is substantially sold in conjunction with the offerings of Delta Dental when clients desire a prepaid dental capitation option. During 1996, Flagship was licensed and began operations in Pennsylvania, but in 1999, determined that its growth potential in that state was limited, and the responsibility for expansion in that market should be assumed by Delta Dental of Pennsylvania. All operations in that state were discontinued by Flagship in 2003.

Flagship has no employees. Flagship has an inter-company service agreement with Delta Dental of New Jersey Inc. (Delta Dental), under which Delta Dental provides administrative services to Flagship, which includes certain aspects of marketing, billing and collections of subscription revenue. Flagship reimburses Delta Dental for these services based upon methodologies and allocations inherent in the agreement.

Flagship also has a coverage agreement with Delta Dental, under which Delta Dental provides coverage for specialty dental services for a premium based upon the total subscribers covered by Flagship, multiplied by the applicable monthly rate in the agreement.

The above agreements will be discussed in detail under the captioned heading of this report titled "Inter-company agreements".

Flagship currently maintains a dedicated claims operations unit, which performs most services necessary to support the DeltaCare product, including group and dental facility file maintenance, payment of capitation, claims and broker commissions, production of group bills, encounter and specialty referral-claims processing, and customer service. Responsibilities are segregated by job role and access security level to support stringent internal controls.

Flagship's current group market consists of four major sectors: municipalities, commercial business, schools, and hospitals. There are currently 326 unique covered employers and other plan sponsors consisting of nearly 23,000 primary subscribers, for a total membership of over 50,000.

Sales and marketing of Flagship's dental plans is performed by the marketing personnel of Delta Dental. Sales are made either directly by Delta Dental's account executives or through licensed independent brokers. Approximately 150

independent insurance brokers receive commissions from Flagship based on 3 percent of the premium paid by the employer group(s) for whom they are the broker of record.

Limited use is made of advertising through print and radio. Such efforts are generally focused on expanding awareness and familiarity with the Delta Dental brand rather than on promoting specific products. Flagship primarily targets independent insurance brokers and employers through direct mailings and telephone contact.

### **INTERCOMPANY AGREEMENTS**

At December 31, 2006, the Flagship maintained two inter-company agreements with related parties. These agreements have been summarized as follows:

#### **Inter-Company Service Agreement:**

On December 1, 1993, Flagship Health Systems, Inc., a wholly owned subsidiary of DDPNJ Corp., entered into an inter-company service agreement with Delta Dental of New Jersey, Inc. Under this agreement, Delta will provide Flagship with all necessary facilities, equipment and supplies, personnel and services required to implement and maintain Flagship's operations as a dental plan organization. Additionally, Delta shall make "payments of convenience" on behalf of Flagship to third parties as requested by Flagship in writing. These payments may include, but not be limited to, payment of payroll and claims. Delta shall account for such payments by charging the inter-company account of Flagship for the amount of the payment. Delta shall not be entitled to any commission or fee for making such payments.

This service agreement was amended on July 1, 1997 through an addendum to allow Flagship full use of the STC System which Delta purchased on or about April 1997 for the purpose of supporting Delta Dental Plan of Illinois' capitation business. Under the terms of this addendum, Delta and Flagship shall establish a monthly rate for use of the STC System that will fairly compensate Delta for the cost of additional modification and implementation that Delta will cause to be made to the STC System.

On June 1, 1999 a second addendum to the original inter-company service agreement was implemented authorizing Flagship to perform DeltaCare specialty claims processing for Delta at an hourly rate of \$30.00. The claims processing fees shall be invoiced periodically and shall be paid within 30 days of invoice. This rate may be adjusted annually by the parties to reflect a fair allocation of the cost, with such adjustments in writing and signed by both parties to the agreement.

#### **Contract for Specialty Dental Services:**

Delta Dental and Flagship Health Systems entered into a contract for specialty dental services (effective January 1, 2004) whereby the New Jersey Dental Service Plan (NJDSP) will arrange for certain NJDSP-designated dentists to perform specialty dental services for enrollees of Flagship's dental plans, and Flagship will compensate the Plan for specialty dental services performed by NJDSP-designated dentists out of the capitation premiums received by Flagship. The specialty dentists who agree to provide these services will do so under the terms of the Schedule of Services and Co-payments attached to the contract as Exhibit A. Flagship agrees that it will compensate NJDSP directly for all specialty services performed by NJDSP-designated dental specialists for enrollees of its dental plans according to the Premium Schedule attached to the Contract and labeled Exhibit B.

All of the above agreements were submitted to the NJDOBI by the Company.

### **MANAGEMENT AND CONTROL**

Flagship's By-laws provide that the annual meeting of shareholders shall be held upon not less than ten nor more than 60 days written notice of the time, place, and purposes of the meeting during the month of June of each year at the

Company's offices, or at such other time and place as shall be specified in the notice of the meeting, in order to elect Directors and transact such other business as shall come before the meeting.

The By-laws provide that the Board of Directors shall have the general charge and management of the affairs, funds and property of the Corporation. The Board of Directors shall be comprised of no more than nine and no less than three members. Each Director shall be elected by the shareholders at each annual meeting and shall hold office until the next annual meeting of shareholders and until that Director's successor shall have elected and qualified.

A regular meeting of the Board shall be held without notice immediately following and at the same place as the annual shareholder's meeting for the purposes of electing officers and conducting such other business as may come before the meeting. The Board, by resolution, may provide for additional regular meetings which may be held without notice, except to members not present at the time of the adoption of the resolution.

A special meeting of the Board may be called at any time by the President or by Directors for any purpose. Such meetings shall be held upon three days notice if given orally, (either by telephone or in person), or by telegraph, or by three days notice if given by depositing the notice in the United States mails, postage prepaid. Such notice shall specify the time and place of the meeting.

A majority of the entire Board shall constitute a quorum for the transaction of business.

At December 31, 2006, the following six members were serving on the Board of Directors:

<u>Name and Business/Home Address</u>	<u>Principal Occupation</u>
Gerald A. Sydel, DDS 1020 Johnston Drive Watchung, NJ 07069	Dentist Chairman of the Board, Delta Dental of New Jersey, Inc.
Walter Joseph Van Brunt 13 Crystal Rock Road Sparta, NJ 07871	President and CEO, Delta Dental of New Jersey, Inc.
Louis Bernard Lombardi 109 Knolls Road Bloomington, NJ 07403	First Senior Vice President (Retired) Bank of New York, West Paterson, NJ
William Faulkner 90 Fairview Avenue Long Valley, NJ 07853	Retired
Martin Anthony Lukacs, DDS 311 Brook Drive Milltown, NJ 08850	Dentist-Private Practice
Morton Reinhart 45 Lisa Terrace Somerville, NJ 08876	President Reinhart Associates, Inc.

The Board of Directors' location for all correspondence is the Flagship home office, 1639 Route 10, Parsippany, New Jersey 07054.

During 2006, the Board of Directors' held one meeting.

The following officers of Flagship Health Systems Inc. were elected for the 2006-2007 term at the Board of Director's meeting held on June 26, 2006:

<u>Name</u>	<u>Title</u>
Walter Van Brunt	President and Chief Executive Officer
James Suleski	Sr. Vice President, CFO and Treasurer
Douglas G. Sanborn, Esq.	Sr. Vice President, General Counsel and Secretary
Vincent M. Farinella	Vice President and Assistant Secretary
D. Scott Navarro, DDS	Director of Dental Services

Flagship had an Executive Committee as at December 31, 2006 but it did not meet during 2006. The Company also had a third level Credentialing Committee which did not meet during 2006.

The Board of Trustees meetings were all well attended during the examination period. A review of the minutes of these meetings indicated that investment transactions and other financial information were adequately supported and approved.

### **CONTINUITY OF OPERATIONS**

Disaster recovery for the accounting and other functions of Flagship Health Systems, Inc. is done in conjunction with Delta Dental of New Jersey, Inc.. While marketing, actuarial and finance/accounting support is shared with Delta Dental all information and transaction processing for the DeltaCare product relies on the availability of SeeBeyond DataDental system which is independent of Delta Dental.

Those functions that are shared with Delta Dental of New Jersey Inc. include the following:

Member Eligibility Entry and Maintenance (Premium Billing)  
Posting and Allocating Payments (Accounting)  
General Accounting Functions (Accounting)  
Security Functions and Set-Up (Information Services)

In the event of a disaster certain functions of Flagship are deferrable in nature and can be considered non-critical. In the event of a disaster all non-critical functions will be suspended. Those functions are as follows:

Encounter form processing  
Network recruitment efforts  
Dental office facility evaluation  
Credentialing performed during the course of such evaluations  
Utilization data analysis

### **POLICY ON CONFLICT OF INTEREST**

Flagship has a formal program for the completion of annual questionnaires and the submission of signed statements of compliance in connection with Flagship's policy on conflict of interest. Under this program statements of compliance are to be completed by each trustee, officer, consultant, advisor, key employee, and non-trustee member of a standing committee. The program and procedures are set forth in the Statement of Policy on The Matter of Conflict of Interest dated May 12, 2001.

Flagship provided all completed conflict of interest questionnaires for the period under examination. The examination noted that there were no apparent or potential conflicts of interest reported during the examination period.

## **FIDELITY BOND AND OTHER INSURANCE COVERAGE**

Flagship is covered under a commercial crime policy through its parent, Delta Dental of New Jersey, Inc. that contains a blanket fidelity coverage form with a single loss limit of insurance of \$1,350,000. This fidelity coverage is deemed adequate to satisfy the minimum amounts of fidelity insurance coverage as suggested by the National Association of Insurance Commissioners (NAIC) exposure index.

Flagship also has insurance coverage through its parent company for the protection of its assets from losses arising due to the day to day business operations of a dental service corporation. The following outline shows the types and amounts of coverage that were in force at December 31, 2006:

<u>Type of Coverage</u>	<u>Amount of Limits</u>
Commercial Crime	\$1,000,000 (Forgery or Alteration) \$1,000,000 (Computer Fraud)
Managed Care Professional Liability (including Claims Expense)	\$10,000,000 (each claim) \$10,000,000 (aggregate)
Directors and Officers Insurance and Reimbursement Liability	\$15,000,000 (each policy year) \$5,000,000 (each claim)
Employment Practices	\$5,000,000 (annual aggregate)
Specific Property Liability	\$3,000,000 (contents - replacement cost) \$ 500,000 (extra expense) \$ 150,000 (valuable papers) \$6,500,000 (EDP equipment) \$ 9,740 (fine arts)
Commercial General Liability	\$2,000,000 (general aggregate) \$1,000,000 (products & completed operations - aggregate) \$1,000,000 (personal & advertising injury) \$ 10,000 (medical expense -any one person)
Umbrella and Excess Liability: Chubb	\$10,000,000
Fireman's Fund	\$15,000,000
Workers' Compensation and Employer's Liability	\$1,000,000 (each accident) \$1,000,000 (disease - policy limit) \$1,000,000 (disease - each employee)
Automobile Liability	\$1,000,000 (each accident)
Fiduciary Liability	\$2,000,000



### **EMPLOYEE WELFARE AND BENEFIT PLANS**

Flagship has no employees of its own but utilizes the employees of its parent company, Delta Dental of New Jersey, Inc., through an inter-company service agreement. The parent, Delta Dental, makes available and provides to its employees, once certain eligibility requirements are met, the following fringe benefits:

#### **Coverage/benefit Type:**

401(k) and Profit Sharing Plan  
Deferred Compensation Plan  
Pension Plan  
Management Incentive Plan  
Administrative Days  
Benefit Conversion at Termination  
Medical, Dental, Vision and Prescription Drug Coverage  
Family Leave  
Life Insurance  
Long Term Disability  
Medical Leave  
Military Leave  
Short-Term Disability  
Supplemental Life Insurance  
Vacation Benefits  
Flextime Scheduling  
Flexible Spending Account  
Volunteer Days  
Educational Reimbursement

### **POLICY FORMS AND UNDERWRITING PRACTICES**

Since Flagship markets and administers prepaid dental capitation plans there is no underwriting involved. Flagship earns subscription revenue from 326 group contracts written under 22 plans filed with the NJDOBI. Subscription fees are billed and paid by member groups and recognized as income by Flagship on a monthly basis. The groups provide a monthly listing of enrollees with the group which the premiums are based on per enrollee. Flagship generates its own bills. Premium receipt reports are compiled monthly and sent to Delta Dental accounting for financial processing.

Flagship pays no claims but capitation amounts are paid to the dentists on a monthly basis for the specific subscribers assigned during the month. The average amount for individuals is approximately \$9.00 per individual covered person (subscribers plus dependents). Flagship records these payments as an expense on a monthly basis. Payments are authorized by Vincent Farinella, Vice President of Flagship, and checks are signed by facsimile signature by James Suleski, Senior Vice President and Chief Financial Officer, and Walter Van Brunt, President and Chief Executive Officer.

### **ACCOUNTS AND RECORDS**

As of April 26, 1999, Flagship converted all of its operations to the SeeBeyond DataDental system, a stand-alone client-server system utilizing the Informix database, UNIX operating system, and Sun Solaris servers. The system is connected to clients (desktop PCs) via a TCP-IP protocol through a local area network (LAN). The software is owned and developed by SeeBeyond Technologies, Inc. (formerly Software Technologies Corporation, Inc.) of Monrovia, California. Flagship has a master software license agreement with SeeBeyond for use of the Data Dental application and related software ("DataLoad") that permits electronic eligibility, encounters, and claims to be loaded into DataDental. A support and upgrade contract for both applications is maintained with Prime Tech Staffing Services, Inc. of Huntington

Beach, California. Prime Tech performs all support and "help-desk" services and develops system upgrade and maintenance releases.

Flagship's book of business (The DeltaCare product) is managed almost exclusively through the DataDental system. The Flagship operating unit now performs nearly all services and transactions necessary to manage and support the DeltaCare product, including group file, dental facility file, and producer file maintenance, payment of capitation, specialty claims and broker commissions, production of group bills, management of national accounts, operational and financial report production, patient encounter and specialty referral claims processing. Flagship continues to maintain a dedicated customer service unit, which handles phone inquiries and written correspondence from members, dentists and employer groups.

While Flagship continues to receive intercompany support from Delta Dental for marketing services, underwriting and actuarial services, and finance-accounting services, all information and transaction processing for the DeltaCare product relies on the availability of the DataDental system.

### **TREATMENT OF SUBSCRIBERS**

The Company's complaint register for complaints filed with the Department of Banking and Insurance for the years 2002 through 2006 and other written complaints for the examination period which Flagship received directly from other subscribers were reviewed. The inspection of these complaints determined that the treatment of subscribers was in compliance with N.J.S.A. 17:48D-12 (Complaint System) and N.J.S.A. 17:29B-4(10) (Complaint Handling Procedures).

### **FINANCIAL STATEMENTS AND OTHER EXHIBITS**

Exhibit A - Statutory Balance Sheet as of December 31, 2006 and December 31, 2001

Exhibit B - Underwriting & Investment Exhibit for the Five Year Period Ending December 31, 2006

Exhibit C – Capital and Surplus Account for the Period Ended December 31, 2006

STATUTORY BALANCE SHEET AS OF DECEMBER 31, 2006 AND DECEMBER 31, 2001

	DECEMBER 31, <u>2006</u>	DECEMBER 31, <u>2001</u>	NOTE <u>NUMBER</u>
<u>ASSETS</u>			
Bonds	\$0	\$0	
Common Stocks	0	0	
Cash & Short Term Investments	1,397,175	2,894,796	1
Accident and Health Premiums Due and Unpaid	0	892,027	
Investment Income Due and Accrued	2,967	3,197	
Agents' Balances in Course of Collection	421,067	0	
Receivables from Parent, Subsidiaries and Affiliates	0	0	
Aggregate write-ins for other than invested assets	<u>18,479</u>	<u>124,627</u>	
Total Admitted Assets	<u>\$1,839,688</u>	<u>\$3,914,647</u>	
<u>LIABILITIES</u>			
Claims Unpaid	\$0	\$0	
Unpaid Claims Adjustment Expenses	69,620	40,811	2
Premiums Received in Advance	0	0	
General Expenses Due or Accrued	34,810	20,710	
Amount Withheld or Retained for Account of Others	0	0	
Borrowed Money	0	0	
Amounts Due to Parent, Subsidiaries and Affiliates	373,927	2,752,724	
Payable for Securities	0	0	
Aggregate write-ins for other liabilities	<u>0</u>	<u>200</u>	
Total Liabilities	<u>\$478,357</u>	<u>\$2,814,445</u>	
<u>CAPITAL AND SURPLUS</u>			
Common Capital Stock	\$5,000	\$5,000	3
Gross Paid in and Contributed Surplus	1,245,000	1,245,000	3
Unassigned Funds	<u>111,331</u>	<u>(149,798)</u>	3
Total Capital and Surplus	<u>\$1,361,331</u>	<u>\$1,100,202</u>	
Total Liabilities, Capital and Surplus	<u>\$1,839,688</u>	<u>\$3,914,647</u>	

UNDERWRITING AND INVESTMENT EXHIBIT FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 2006

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
<u>Underwriting Income</u>					
Net Premium Income	<u>\$8,547,986</u>	<u>\$8,802,317</u>	<u>\$9,108,600</u>	<u>\$9,375,563</u>	<u>\$9,674,262</u>
Deduct:					
Hospital/Medical Benefits	<u>\$7,789,483</u>	<u>\$7,682,310</u>	<u>\$7,657,937</u>	<u>\$7,732,048</u>	<u>\$7,942,721</u>
Claim Adjustment Expenses	<u>713,073</u>	<u>758,865</u>	<u>896,270</u>	<u>925,394</u>	<u>926,063</u>
Administrative Expenses	<u>356,644</u>	<u>372,521</u>	<u>448,098</u>	<u>471,743</u>	<u>457,734</u>
Total Underwriting Deductions	<u>\$8,859,200</u>	<u>\$8,813,696</u>	<u>\$9,002,305</u>	<u>\$9,129,185</u>	<u>\$9,326,518</u>
Net Underwriting Gain or (-) Loss	<u>(\$311,214)</u>	<u>(\$11,379)</u>	<u>\$106,295</u>	<u>\$246,378</u>	<u>\$347,744</u>
<u>Investment Income</u>					
Net Investment Income Earned	<u>\$30,641</u>	<u>\$14,168</u>	<u>\$9,638</u>	<u>\$35,059</u>	<u>\$52,147</u>
Net Realized Capital Gain	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Investment Gain or (Loss)	<u>\$30,641</u>	<u>\$14,168</u>	<u>\$9,638</u>	<u>\$35,059</u>	<u>\$52,147</u>
<u>Other Income</u>					
Net Gain or (Loss) From Agents' or Premium Balances Charged Off	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Aggregate Write-ins for Other Income or Expenses	<u>(64,476)</u>	<u>(51,092)</u>	<u>(9,911)</u>	<u>(18,390)</u>	<u>(24,983)</u>
Total Other Income	<u>(\$64,476)</u>	<u>(\$51,092)</u>	<u>(\$9,911)</u>	<u>(\$18,390)</u>	<u>(\$24,983)</u>
Net Income After Capital Gains Tax and Before Federal Income Taxes Incurred	<u>(345,049)</u>	<u>(48,303)</u>	<u>106,022</u>	<u>263,047</u>	<u>374,908</u>
Federal and Foreign Income Taxes Incurred	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Net Income (Loss)	<u>(345,049)</u>	<u>(48,303)</u>	<u>106,022</u>	<u>263,047</u>	<u>374,908</u>

CAPITAL AND SURPLUS  
FOR THE PERIOD  
DECEMBER 31, 2001 TO DECEMBER 31, 2006

EXHIBIT C

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Capital and Surplus, December 31, Previous Year	\$1,100,202	\$687,713	\$539,672	\$814,873	\$1,083,958
Net Income (Loss)	(345,049)	(48,303)	106,022	263,047	374,908
Change in Non-Admitted Assets	<u>(67,440)</u>	<u>(99,738)</u>	<u>169,179</u>	<u>6,038</u>	<u>(97,535)</u>
Change in Capital and Surplus	<u>(\$412,489)</u>	<u>(\$148,041)</u>	<u>\$275,201</u>	<u>\$269,085</u>	<u>\$277,373</u>
Capital and Surplus, December 31, Current Year	<u>\$687,713</u>	<u>\$539,672</u>	<u>\$814,873</u>	<u>\$1,083,958</u>	<u>\$1,361,331</u>

## **NOTES TO FINANCIAL STATEMENTS**

### **1. Cash on Hand and Short Term Investments**

The Company, at December 31, 2006 maintained a positive cash balance of \$961,011 which was added to the positive short-term investments amount of \$436,164 resulting in a collectively reported financial statement balance of \$1,397,175 for Cash and Short-term Investments at year end.

Amounts were verified by direct confirmations which were received from the respective depositories. A review was performed of the Company's escheat procedures, how they handle stale dated checks in regard to unclaimed payments and refunds, its liability for escheatable funds and actual amounts applicable to and remitted during examination year December 31, 2001 as well as 2006 which indicated the company complied with N.J.S.A. 46:30.

### **2. Unpaid Claims Adjustment Expenses**

The Company reported \$69,620 for Unpaid Claim Adjustment Expenses at December 31, 2006. This amount represented 66.66% of the total expenses payable of \$104,430 when allocated out against general expenses. A test-check of subsequent payments and allocation percentages determined this liability to be adequate.

### **3. Contingency Reserves and Unassigned Funds**

Flagship reported \$1,361,331 for total capital and surplus at December 31, 2006.

This amount consisted of the following:

Common Capital Stock	\$ 5,000
Gross Paid in and Contributed Surplus	1,245,000
Unassigned Funds	<u>111,331</u>
Total	<u>\$ 1,361,331</u>

The \$5,000 in common stock issued and outstanding is held solely by its parent, DDPNJ Corp. Flagship has no surplus debentures.

The examination will accept as stated the amount reported by Flagship for contingency reserves and unassigned funds at December 31, 2006.

## **SUMMARY OF SIGNIFICANT SUBSEQUENT EVENTS**

The following is a summary of significant events occurring subsequent to December 31, 2006:

An election of officers took place on June 25, 2007. Dr. Martin Lukas has retired from the Flagship Board of Directors, effective October, 2007.

The Company entered into a contract effective 7/17/07 with Kimberly Unclaimed Property Services to manage escheat and unclaimed property.

No other significant subsequent events were noted.

## **SUMMARY OF EXAMINATION RECOMMENDATIONS**

No material recommendations were noted that were substantial enough to be mentioned in this report.

### CONCLUSION

The examination was conducted by the undersigned with the assistance of the New Jersey Department of Banking and Insurance, Office of Solvency Regulation field and office staff, at Flagship's home office located at 1639 Route 10, Parsippany, New Jersey 07054.

The courteous assistance and cooperation of Flagship's officers, employees and certified public accounting firm is acknowledged.

Respectively submitted,

/S/

Daniel J. Fialkowski  
Supervising Insurance Examiner  
New Jersey Department of Banking and Insurance

FLAGSHIP HEALTH SYSTEMS, INC.

I, Daniel J. Fialkowski, do solemnly swear that the foregoing report of examination is hereby represented to be a full and true statement of the condition and affairs of the subject insurer as of December 31, 2006 to the best of my information, knowledge and belief.

Respectfully submitted,

/S/

Daniel J. Fialkowski  
Supervising Insurance Examiner  
New Jersey Department of Banking and Insurance

State of New Jersey  
County of Mercer

Subscribed and sworn to before me, Catherine M. Liptak, on  
This 24th day of January, 2008.

/S/

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Notary Public of New Jersey

My commission expires: January 21, 2013